The political economy of markets*

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* This is a shortened version of a forthcoming paper of the same title.

What is a market?

Markets are institutions that exist to facilitate exchange, that is, they exist in order to reduce the cost of carrying out exchange transactions.

Ronald Coase, *The Firm, the Market and the Law.*

Two points to emphasise:

- Markets are institutions.
- They have a specific purpose or function – they are *specialised* institutions – a feature that facilitates assessment of their effectiveness/performance.

What is an institution?

Institutions are systems of established and prevalent social rules that structure, govern or regulate social interactions.

- Notes:
  - Established => a degree of 'givenness' and durability to individuals.
  - Prevalent => the rules are shared by many.
  - Rules: a term to be construed broadly so as to encompass not just laws and formal regulations, but also norms (e.g. 'good faith' trading), conventions and customary practices, right down to shared habits, understandings and heuristics. (Roughly: formal rules + market culture.)

The duality of 'market societies'

A *shared/collective* system of rules

governing conduct in a way that serves to promote

Transactions between *individual* economic agents

A specific purpose, but multiple by-products

- Economic prosperity.
- Economic freedom/liberty.
- Socialization:
  - Induction into the ‘rules’.
  - Relatively weak, intermittent social interactions (compared with say family or intra-organisational interactions).
  - But large numbers of counter-parties (a wide network of actual and potential ‘others’).
- Effects on other institutions: e.g. see the tradition/modernity debate.

Does governance => politics?

- In principle, markets can emerge from an evolutionary process of competition and selection.
- Individual proprietors can offer participation in formal systems of rules in return for membership payments and can compete with one another in so doing. Examples: English markets in the middle ages, commodity exchanges, Amazon Marketplace, etc.
- In practice, most (though not all) modern markets rely to a greater or lesser degree or other on sub-sets of their rules that are determined and enforced by processes of collective choice (e.g. statute law).
- It is the *nature* of the political processes at work that matters, not their existence.

A digression on English history

- The ‘England problem’ in German scholarship.
- Marx, transition from feudalism to capitalism, but:
  - “… in England, the feudal era ended scarcely after it had begun” (Eisenberg), leaving a gap between the two ‘systems’ extending over several centuries.
- Weber, the rationality of industrial capitalism + the Protestant ethic, but:
  - How to explain the Common Law and attachments to ‘tradition’.
  - Commercial society exhibited extensive development in Catholic England.
- Conjecture: a failure to understand the duality of market society: individualism + strong attachment to the rules (institutions).

The individualism side of the story

- MacFarlane’s *Origins of English Individualism* (1978).
- Detailed parish records and other sources point to major aspects of modernity as far back as those sources go. E.g. relatively high degrees of geographic and social mobility, late age of marriage, etc.
- Individuals were not tied to place, family or lord.
- No major breach between ‘tradition’ and ‘modernity’.
- The ‘carnival’ aspects of the *Canterbury Tales* (late 14th century) are not remote from a night on the town on any given Saturday in Newcastle.

The collectivism side of the story

- Correlate: alongside these patterns there was an unusually dense network of local markets (numbered in thousands, in a small land area) and relatively lower levels of subsistence or 'for own use' production than on the continent. I.e. institutional density and interdependence were relatively high.
- In Smith's terms, the extent of the market and the division of labour were more developed than elsewhere in Europe in the high medieval period.
- Market rules were therefore prevalent and familiar.
- So was their 'instrumentality': Chaucer's inn-keeper, Harry Bailly devises a story telling contest/competition with an agreed prize, an adjudication arrangement and participation as equals, notwithstanding differences of status and gender. I.e. Bailly *invents* a temporary rule-book.

A relatively enlightened market policy?

- Post-conquest, fiscally challenged sovereigns sought to exert rights to license local markets: part of the struggle between the crown and local lords and the church.
- Not all positive for market development:
  - Prohibition of unlicensed markets, variably enforced.
  - Distance rules – e.g. new licence not to be awarded within six and two third miles of an existing licence.
- However:
  - The licensing system sharpened the focus on the primary purpose of the markets.
  - Opened the way for new proprietors.
  - The Crown was interested chiefly in revenues, not in the detail of market rules.

Enforcement: The Prior of Tynemouth (1290)

- Complaint by the burgesses of Newcastle that the Prior was operating an unlicensed Sunday market, i.e. was competing with their licensed market. (He was also accused of establishing a competing port.)
- Denied by the Prior on the ground that he was doing no more than following the "… practice of other villages of those parts."
- Discovered: a tumbrel, the presence of fishermen and brewers, a leased oven and "stalls for the setting out of bread, meat and fish" (i.e. what might be called the physical infrastructure of a market).
- Decision: if he didn't admit to a market, he should suppress all signs of a market (i.e. dispose of the infrastructure).

Sources of revenue: St Giles Fair, Winchester 1299

Stallage and other rentals	> 50%
Tolls*	20% approx.
Service fees**	10% approx.

* Collected at city gates, bridges and crossroads.

** For use of official weights and measures, fees and fines paid to market courts, ...

Note the incentive structure: other things equal, itinerant merchants bring more revenue because of tolls. Incentives to encourage them rather than to *exclude* them, but price discrimination to extract value.

The outcomes of market development in England pre the industrial revolution

- Economic freedom.
- Prosperity: agricultural productivity much higher than on the continent over a period measured in centuries.
- Extensive non-agricultural production.
- A strongly socialized population enjoying relatively abundant ‘horizontal’ interactions (as opposed to the ‘vertical/hierarchical’ interactions of feudalism and, or more recent periods, of large organisations, whether industrial or bureaucratic).

A relatively unenlightened market policy?

- Today markets are often expected to do rather more than serve their primary purpose/function of reducing the costs of exchange (although the latter priority lives on in competition policies aimed at reducing barriers to trade / restrictions of competition).
- Markets are often seen as instruments for the achievement of other, *specific* purposes (not general purposes such as promoting prosperity, economic freedom or ‘horizontal’ socialization).
- The ‘magic of markets’ rhetoric is unhelpful here because it leads to unrealistically inflated expectations: the story of pot-holes in Krakow.
- The tendency might (inelegantly) be called the ‘re-purposing’ of markets.

Two problems, one familiar one less so

- The first problem with this is partial ‘capture’ of the rule book by a particular interest group (always partial because the complete rule-book, large parts of which are ‘informal’, is beyond the control of any one party, even the state). This is familiar in the study of regulation.
- Those exerting undue influence are willing to trade-off higher transactions costs for the benefits they will receive if they can tilt the outcomes of transactional processes in their favour.
- Markets then function less well in achieving their primary purposes and the beneficial side-effects (general prosperity, freedom, socialization) also tend to be reduced.

Institutional instability

- The second problem is institutional stability.
- The outcomes of transactional processes are inherently uncertain, for example because they depend upon a vast set of information that is unknowable to any one participant or observer.
- Re-purposing implies using the rules as *control variables* to reduce some of the uncertainty in outcomes by ‘targeting’ a certain number of desired outcomes.
- As circumstances change, the ‘controls’ are changed to ‘hit the target’.
- This tends to transfer volatility into the rules themselves, making them more uncertain or unstable.
- But uncertain/unstable rules imply that the institution of the market is itself being undermined.

Volatile targets

- The institutional damage is likely to be less if the targeted outcomes themselves remain stable over time (e.g. if rules are partially captured by an interest with settled aims). Rules will change, but the *rule-change process* will have a certain degree of predictability about it.
- This is a condition unlikely to be satisfied by contemporary politics: the list of politically Good Things to Do may be relatively stable, but priorities tend to shift rapidly in response to new events.
- Risk of de-institutionalisation: loss of trust and confidence in the systems of rules and their governance, reducing the capacity of those institutions to serve their co-ordinating functions.

Thoughts on implications for regulation

- *Regulation is part of a market*, not something distinct from the market. It is concerned with the governance and enforcement of a particular (formal) sub-set of the rules.
- Regulators can therefore easily become agents of the kind of adverse (in some cases destructive) re-purposing of markets just described.
- A signal of this is when there is talk of regulation ‘delivering’ outcomes for government, as if rule-making and enforcement were akin to delivering Pizza.
- Market regulation that seeks to reduce costs of exchange works with the grain of the institution, other purposes tend to cut against it.

Coase revisited: markets vs organisations/hierarchies

- Coase viewed markets and organisations as two different types of form of economic organisation. He focused chiefly on their respective transactions costs, but this can be widened. These are different types of rule-systems, characterised by different cultures (the informal parts of the rules) and different types of 'rationality' (see Weber's 'England Problem').
- Over a millennium or more, the commercial culture is Britain has specialised in market arrangements, and the country's relative performance in this arena has been much better than it has been dealing with hierarchies/large-scale organisation, whether in the form of feudalism, industrial capitalism, or the bureaucracies of modern government.
- A worry: destructive re-purposing of markets may be particularly damaging in Britain because we aren't very good at the alternatives.